
Vulnerability of India for Sub Prime Housing Crisis

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The financial markets are in turmoil. Biggest names in the Investment banking are falling like pack of cards. This is happening in a country which is the torch bearer of Economic reforms and liberalization. We have reached a point where now it is being discussed that whether we should have liberal/free economic reform or conservative economic reform. Lehman Brothers, AIG, Merrill Lynch are facing the liquidity crisis because of the lending to the Subprime borrowers, who did not have the credibility and credentials to borrow funds from the bankers for taking a housing property, but were given loans because of the boom in the real estate market in USA and because Banks were getting higher interest from these subprime borrowers. The interest rates were lower so the bankers and the borrowers both could take advantage of the property boom. The concept of security margin was also compromised out of enthusiasm and to offer better terms to the borrower. This situation was similar to a banker who raises high cost funds because of credibility crisis and in the process lends on higher interest rates and thus can attract only subprime borrowers. Vulnerability of this category of bankers would be high because his borrowers would not be able to compete with his competitors. The balance sheet of these bankers who gave money to subprime borrowers was very attractive because the profits were high because of higher interest rates charged from the subprime borrower and the money was coming back as the property prices were going up and borrowers were paying back and also making money in the process. Did the risk assessment system collapsed? Did the country with best forecasters and planners could not anticipate that cycle can also reverse and the property prices can also come down?

Economic liberalization was implemented by India in a conservative pattern. Indian banks give loan on the basis of the earning and paying capacity of the borrower and the risk associated with the continuation of the job of the borrower is assessed by the banker. It is not done on the basis of the value of the property alone without ascertaining the paying capability of the borrower. Voices were raised that in India, red tape is prevalent and sanctions are not as smooth as one gets in Western world.

The Property prices started coming down with the slowing down of economy. The banks that did not have the security margin by way of promoter's contribution and had only the primary security as mortgage had to resort to taking the possession of these housing properties of subprime borrowers. The supply side of properties increased and the demand was not rising because in a developed economy like USA, housing was not a compulsive need but a supplement to increasing desire. The process of knocking down of property prices became harder as the supply kept on increasing and demand could not keep pace. The crisis reached to that level that even the big bankers started feeling the heat and started collapsing. The Stock market also started feeling the heat of subprime crisis and the investments made by the bankers also reached the lower levels compounding the problem of these giant entities.

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Can it happen in India?

Million dollar question is as to how much vulnerable are we to this type of crisis which even the best economic reformers could not avoid, who always advised India to speed up the reform process. Only time will tell if Our Economic reform mixed with conservative liberalism and some specific characteristics may come to our rescue.

When we go to an Indian Banker, we feel that lot of red tapism is prevalent and so much information, formalities are required to be done we sometimes feel that this is not economic reform. When the bankers ask us to fund 15% of the value of the property, it creates a cushion for the Indian banker as a security margin. In India, it is still difficult to get a loan even against a security (home, etc), if a prospective borrower has defaulted earlier. Owning immediately encashable security like jewellery or stocks might make it a little easier, but not much.

The family support system of India, which has lately started getting dented, still remains strong and helps the individual member of the family to tide over the temporary crisis and regain in better times. Old generation could fore see the evils of over spending and the saving rates in countries like China and India remains more than ¼ th of their GDP. In certain western/developed economies it is around 0% or even in negatives in certain segments of the society.

The entry of the organized retailers has not only changed the buying habits of the Indian consumers but also has contributed to the increased tax collection of the Government. Similarly the housing industry in India is in great transition phase where organized builders are replacing the Small construction agents who were building and selling housing properties, but still large number of house are being made in unorganized sector where the prevalence of black money is still prevalent. So, is the black element of economy also decreases the chances of subprime housing crisis in India? Let us also examine the Need-desire-demand profile of Consumers of USA and India. Here is a country which has 30% of middle class urban population with handsome salary and income, with unfulfilled needs and desires that this category which may constitute a bigger population block than many big countries of the world that it will not allow the

prices to fall below a particular level. In the worst case scenario that the Economic slowdown in Western countries also starts hitting the IT/ Export/Banking sector in India that the Purchasing power of the segment may start hitting the housing sector. Here again the Indian ever increasing population and thus the demand for all type of commodities will work as a buffer for self consumption and prevent India from the economic collapse type of situation in Other countries. The housing shortage in India is about 200 million dwellings of which 50% is in urban area and 70-80% of this is in Low Income group. In just another 5 Years, the shortage will be more than 400 millions. This High shortage of houses will not allow the prices to fall more than a certain percentage. We, as a nation and as a society had a unique distinction of living in joint family system but with the changes in the living styles the time of Nuclear families is also going up and thus the need for more dwellings. Article in Business world on 19th May 2007, wrote that though vast majority of its people live in desperate poverty, yet India is poised to undergo a remarkable transformation .Research from Mc Kinsey Global Institute shows that within a generation India will become a upwardly mobile middle class household majority country .In 2 decades, Country will surpass Germany as the world's 5th Largest consumer market.

The Incentives given by the Government of India in shape of Income tax benefits also makes it economically beneficial decision for the Indian house hold to take a house on loan and thus virtually paying a interest rate of 8%, because of the tax benefits available on housing loan . If the government decides to withdraw the benefit under IT act, India can also face a subprime crisis and NPA of Banks in this particular category may also go up. It is a time when we have to act intelligently. As banks are reducing their interest rates in order to attract the customers, this could also lead to higher default rates in the future. On the eve of diwali almost every bank rushed to grab the share of festival spending and new customers. By doing this banks are taking too much credit risk and in future they might end up with the crisis like rest of the world.

In the end we can say that Indian economy is still saved from the sub prime crisis but yes it is quite possible that in near future when the income of the people will reduce and because of the aggregate

demand will come down and because of that it is quite possible that corporate has to reduce investment and in order to meet the expenses more threats to the jobs of the people. Even now a days we can feel that people are *hording their money and reducing their expenses*. And even in the housing loan segment because of Conservative financing norms are comparatively safer and because the housing loans have been disbursed on the paying capacity of the borrowers , the NPA in housing loans can also increase if the jobs are lost and salaries remain stagnant in

India job market but still, because of ever increasing demand, the housing sector may witness marginal increase in the NPA in this sector.

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